BEFORE THE

FEDERAL TRADE COMMISSION

REBUTTAL OF

PRE-PAID LEGAL SERVICES, INC.

TO COMMENTS MADE TO THE

NOTICE OF PROPOSED RULEMAKING FOR

THE BUSINESS OPPORTUNITY RULE, R511993

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I. INTRODUCTION

Pre-Paid Legal Services, Inc. ("Pre-Paid")[1] hereby respectfully submits its response to comments made by other parties regarding the Federal Trade Commission's ("Commission") Notice of Proposed Rulemaking for the Business Opportunity Rule, R511993.[2] Over 17,000 comments were submitted in response to the Proposed Rule, with the overwhelming majority of them expressing support for its goal, that is, to prevent fraudulent marketing schemes, but also expressing concern that its scope would inadvertently unfairly burden respected direct selling companies and the individuals who are engaged in selling those products or services.

Unfortunately, a few of the comments came from individuals and organizations who apparently believe that any direct selling company that has multilevel marketing is a pyramid scheme. Having failed to make all such companies illegal, those commentators seek to impose upon multilevel marketing companies the most extreme and onerous requirements upon them to make it virtually impossible for these companies and individuals to function in a reasonable and cost-effective manner. Their view is not, however, reality. Pre-Paid – and other similar direct selling companies – are not pyramid schemes when they have independent associates who sell a real product or service and who derive income from the sale of that product or service.

Pre-Paid does agree with these few negative comments about one issue- that potential purchasers should make an informed decision prior to making a purchase. It disagrees with these commentators, however, about what the Proposed Rule should require, because the commentators deliberately either misstate or ignore the information already available or provided to potential purchasers, the effect of a well-established refund policy, and the benefits that

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[1] Pre-Paid designs, underwrites, and markets legal expense plans to more than 1.5 million households throughout the United States and Canada. Pre-Paid is publicly traded (NYSE Symbol: PPD) and had total revenues in excess of $423 million in 2005.

[2] Business Opportunity Rule; Notice of Proposed Rulemaking, 71 Fed. Reg. 19,054 (proposed Apr. 12, 2006) (to be codified at 16 C.F.R. pt. 437) (the "Proposed Rule").

thousands and thousands of participants have obviously received from these marketing opportunities (as demonstrated by the thousands of comments that the Commission has already received from these people). Given these tactics, the Commission should not rely upon a few comments as a justification to make the Proposed Rule even more unreasonably burdensome.

In addition, Pre-Paid again requests that the Commission consider its concerns and modify the Proposed Rule because certain of the Proposed Rule's disclosure requirements would impose unreasonable compliance burdens upon legitimate companies such as Pre-Paid.[3] Additionally, the proposed seven day waiting period is oppressively burdensome and disproportionate to the potential harm in sales of products or services costing $250 or less, especially given the refund policies of companies such as Pre-Paid. Pre-Paid therefore respectfully reiterates its request that the Commission modify the Proposed Rule to provide an exemption for two types of companies: (1) publicly held companies, and (2) privately held companies with (a) revenues in excess of $250 million in each of the past two years and (b) a minimally two-year-old thirty-day refund policy. Alternatively, Pre-Paid has requested that the Commission establish an exemption for companies where the threshold investment is $250 or less. Pre-Paid believes that either of these modifications would allow the Commission to combat fraudulent conduct while also allowing responsible companies, such as Pre-Paid and its almost 500,000 Independent Associates, to engage in their value-creating business activities. Pre-Paid also requests an opportunity to participate in any hearing or workshop that the Commission schedules during its consideration of the Proposed Rule.

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[3] *See* Comments of Pre-Paid Legal Services, Inc. to Notice of Proposed Rulemaking for Business Opportunity Rule, R511993, July 17, 2006 ("Pre-Paid Comments"), *available at* http://ftc.gov/os/comments/businessopprule/522418-11908.pdf.

II. CERTAIN COMMENTATORS MISUNDERSTAND THE PURPOSE OF THE PROPOSED RULE

In contrast to the efforts of the legitimate direct selling community to assist the Commission in crafting a business opportunity rule that balances the Commission's purpose and the needs of businesses, some commentators have instead seized upon the Commission's comment process as an opportunity to repeat discredited accusations about multilevel marketing programs. The Commission, however, has not attempted to change the legal definition of "pyramid scheme," in the Proposed Rule and it does not try to make illegal all direct sellers that have multilevel marketing. Instead, its goal is to target fraudulent marketing schemes.

Despite this, some commentators insist that multilevel marketing programs are generally pyramid schemes and that the Commission should therefore impose such onerous obligations upon them that they could not function.[4] These commentators ignore the law. By law an illegal pyramid scheme is one in which participants are required to pay money in exchange for the right to receive rewards for recruiting other participants into the program, rather than for the sale of the product or service to ultimate users.[5] Pre-Paid and other similar companies are not engaging in pyramid schemes. They market the opportunity to sell a real product or service with real benefits. Furthermore, with respect to Pre-Paid, no commissions are paid for the recruitment of new Independent Associates – commissions are earned from the sale of Pre-Paid Memberships. Commentators ignore this kind of fact when impugning the direct selling industry with a broad brush in order to justify unreasonable obligations. The Commission should not be distracted by the unsupported claims of these few commentators. A few of Pre-Paid's specific objections follow.

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[4] Comment of the Consumer Awareness Institute to Notice of Proposed Rulemaking for Business Opportunity Rule, R511993, July 13, 2006 ("Consumer Awareness Comments"), revised, at 2.

[5] *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1180 (1975), *aff'd sub nom. Turner v. FTC*, 580 F.2d 701 (D.C. Cir. 1978).

A. Earnings Claims

The FTC has proposed that any seller that makes earnings claims would have to provide the prospective purchaser with a detailed earnings claim statement.[6] Pre-Paid and other commentators stated in their comments that the definition of "earnings claims" is too broad and would cause the recruiting process to become burdensome, especially when a refund policy is already in place.[7] Pre-Paid also explained that the required disclosure of ways in which the circumstances of a person making an earnings claim may differ materially from a prospective purchaser's circumstances could well require an intensive examination of many factors, with no clear means of determining which circumstances have been "material" to an Independent Associate's success.[8] Pre-Paid's concern about this requirement has been unmitigated by the arguments of other interested parties.

The commentators who dislike multilevel marketing companies generally have proposed even more onerous "earnings claims" disclosure requirements. One, for example, has suggested that sellers of business opportunities should be forced to disclose the net average income of their independent associates, as opposed to gross income.[9] Pre-Paid believes that such a requirement would be highly misleading for several reasons. First, such a number would ignore that individual experience varies widely in selling the opportunity, because individual initiative plays a critical role in the success of the seller. Additionally, although individual results may vary, it indisputably is possible for a purchaser to generate significant income from the sale of a company such as Pre-Paid's business opportunity. "Average results" blur this truth, because not every purchaser seeks significant income from the sale of the business opportunity. Second, averaging distorts the point that in Pre-Paid's case, only the new associate kit is required

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6 Proposed Rule, 71 Fed. Reg. 19,054, 19,088-89.

7 *See* Pre-Paid Comments, at 10.

8 *See* Pre-Paid Comments, at 9-10.

9 Pyramid Scheme Alert Comments, at 9.

to sell the basic Pre-Paid legal plan Membership. There is no further investment required. To the extent Independent Associates wish to invest in additional training or to sell more specialized products or services, they may do so. But the investment required to sell the basic Pre-Paid service still would be only the cost of purchasing the new associate kit. Thus, Pre-Paid restates that the Commission should modify the Proposed Rule to allow for the exemptions described above and, in any event, it should not include averaging in any earnings statement that is required.[10]

B. Cancellation and Refund Requests

The Proposed Rule requires the "seller" to disclose the total number of purchasers in the past two years and the total number of cancellation requests.[11] Pre-Paid and many other commentators have explained that, where a business opportunity seller has established a liberal refund policy, disclosing refunds provides little information to the potential purchaser.[12] No commentator has successfully refuted this point.[13]

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[10] The Commission should also reject the incredible suggestion that not only should disclosures be made to potential purchasers of a business opportunity, but that the same disclosures also should be made available on a quarterly basis to all individuals who have already purchased and decided not to return the business opportunity. Comments of Martland & Brooks, LLP to Notice of Proposed Rulemaking for Business Opportunity Rule, 16 CFR Part 437 ("Martland & Brooks Comments"), at 14. *See also,* Pyramid Scheme Alert Comments at 8-10; Consumer Awareness Comments, at 3-4; Comments of Quackwatch to Notice of Proposed Rulemaking for Business Opportunity Rule, 16 CFR Part 437. Pre-Paid specifically objects to such a tremendous potential burden. As Pre-Paid previously has argued, the proposed disclosures would be largely unhelpful to prospective purchasers – distributing them to Independent Associates who neither want nor need them would only compound the needless costs.

[11] Proposed Rule, 71 Fed. Reg. 19,054, 19,088.

[12] *See* Pre-Paid Comments, at 8; *see also* Comment Submitted by Quixtar, Inc. to the Federal Trade Commission in Response to the Proposed Business Opportunity Rule, R511993, July 17, 2006.

[13] Jon M. Taylor admits that the return rate for business opportunities is low, but rather than attributing this low return rate to purchaser satisfaction, he instead states that it is because the millions of purchasers of direct selling business opportunities require months or years to become "deprogrammed," or because there is a stigma attached to requesting a refund. *See, e.g.,*

Notwithstanding this point, the anti-direct selling commentators seek even more onerous detailed information about cancellations and refunds. One set of comments suggests that "[s]ellers should be required to state the number of cancellation or refund requests on a monthly or quarterly basis, as well as the number of new and exiting distributors."[14] Such requirements are unnecessary and misleading. The selling of many direct seller products and services is a part-time occupation. Individuals may stop selling Pre-Paid legal plan memberships for any number of reasons having no relation at all to the quality of Pre-Paid's business opportunity. In the context of a required disclosure, providing potential purchasers with raw numbers may inaccurately suggest that people are canceling due to dissatisfaction with the actual opportunity. Although this inaccurate impression would certainly serve the interests of some commentators, the is no connection between the impression and reality. A cancellation simply means that an Independent Associate has chosen to spend his or her time on other pursuits. It does not mean, as some would like to imply, that there is an inherent deficiency in a business opportunity. Thus, the Commission should not accept this proposal.

C. Litigation History

The Proposed Rule would require that direct sellers disclose all litigation in the past ten years, regardless of outcome.[15] In its comments, Pre-Paid noted that it already makes litigation disclosures in its annual report, pursuant to securities laws requirements.[16] Pre-Paid also expressed concern that this requirement would also require disclosure of matters wholly

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Consumer Awareness Comments, at 7. He offers no support for such radical claims, and they should be rejected.

[14] Martland & Brooks Comments, at 16.

[15] Proposed Rule, 71 Fed. Reg. 19,054, 19,088.

[16] *See, e.g.*, Consumer Awareness Comments, at 7 (suggesting that reports of prior business experience also be disclosed).

unrelated to the quality of Pre-Paid's services.[17] Several of the anti-multilevel marketing commentators have taken the Proposed Rule even further by seeking to *widen* the breadth of the litigation disclosures. For example, some have suggested that the disclosure of litigation history should include information about the seller's officers, directors, sales managers, and persons performing similar functions, including high level distributors who produce and sell their own promotional materials, and that the disclosure of litigation should include not only civil and criminal actions, but also arbitrations, bankruptcies and breach of contract lawsuits by and against the Seller, its officers, directors, sales managers and persons performing similar functions.[18]

To adopt such a rule would radically expand the Commission's proposal and would, in fact, impede a prospective purchaser's ability to evaluate a prospective business opportunity because the fraudulent fly-by-night companies that pop up for brief periods of time (the true targets of the Proposed Rule) would likely have no litigation history or would falsify that which they did have. Also, given the litigation to which any large company is subject, prospective purchasers would be overwhelmed by meaningless information. Again, this suggestion should be rejected.[19]

D. References

The Proposed Rule would require the seller to provide the prospective purchaser with references.[20] Several direct selling companies, including Pre-Paid, have expressed concern

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[17] *Id.* The limited disclosure permissions of the Proposed Rule do not clarify the substance of the litigation against the business opportunity seller.

[18] Martland & Brooks Comments, at 15.

[19] So too should the suggestion that the Proposed Rule should be amended to create a private right of action be rejected. *See* Martland & Brooks Comments, at 18. This radical proposal goes beyond the Federal Trade Commission Act and the Franchise Rule do not include a similar cause of action. Individuals already have common law fraud claims that they may pursue if they believe they have been the victim of fraudulent misconduct.

[20] Proposed Rule, 71 Fed. Reg. 19,054, 19,088.

about the potential abuse inherent in the proposed reference disclosure, which would require that sellers of business opportunities provide to potential purchasers a list of the ten closest purchasers of the business opportunity, or a nationwide list of purchasers.[21] These commentators are concerned about the negative consequences of disclosing clients, violating their rights to privacy, and the logistical impracticality of providing such lists.[22]

Pre-Paid's concerns about privacy rights have not been allayed by the comments of the anti-directing selling commentators. For example, commentators have argued that the concern of sellers of business opportunities for the privacy of their purchasers reflects some nefarious desire to hide the identity of its Independent Associates.[23] This argument demonstrates a failure to comprehend direct sellers' concerns about the issue, and a lack of understanding about the relationship between direct selling companies and their independent agents. First, the argument fails to address sellers' serious concerns about identity theft. Second, the argument ignores the concern of direct sellers in protecting client lists from competitors. For example, Pre-Paid has built a nationwide organization, and it is unfair that a rival seller of similar business opportunities should have open access to its list of Independent Associates. Second, current Pre-Paid Independent Associates are unlikely to want to have their information divulged to a

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[21] Comments of Avon Products, Inc. to Business Opportunity Rule, R511993, July 17, 2006 ("Avon Comments"), at 17; Comments of Americans for Tax Reform to Business Opportunity Rule, R511993, July 29, 2006, at 1; Comment of International Business Owners Association International to Business Opportunity Rule, R511993, July 17, 2006, at 7-9; Comments of Mary Kay Inc. to Business Opportunity Rule, R511993, July 17, 2006, at 6-8; Comments of National Black Chamber of Commerce to Business Opportunity Rule, R511993, July 17, 2006, at 3-4; Comments of Primerica Financial Services, Inc. to Business Opportunity Rule, R511993, July 17, 2006, at 23-26.

[22] The anti-direct sellers again take this proposed requirement even further. One suggests that five of the contacts should be ex-participants. Consumer Awareness Comments, at 5. This requirement is novel and would violate the privacy of former participants, in addition to being unreasonably burdensome and uninformative. Such a disclosure will not provide accurate information and does not justify the administrative burden and violation of privacy rights, which could lead to identity theft.

[23] Martland & Brooks Comments, at 17.

potential purchaser of a new associate kit. Most of Pre-Paid's Independent Associates sell legal plans part-time, and their interest is in selling legal plans, not in providing references for potential purchasers of the business opportunity. Third, even if an Independent Associate is willing to divulge his contact information to a potential purchaser of a new associate kit, he should not be required to do so.[24]

E. Waiting Period

The Proposed Rule would require that the seller furnish the purchaser with material information at least seven days before the purchaser signs a contract or makes a payment.[25] Pre-Paid registered its concerns about the proposed seven-day waiting period in its initial comments.[26] The waiting period would paint direct selling in a negative light and create an unreasonable burden, a burden not faced by sellers of consumer goods costing much more than Pre-Paid's new associate kit. Moreover, no anti-direct marketing commentator has demonstrated that an adequate return policy does not provide *more* protection to the consumer than the proposed seven-day waiting period. Pre-Paid maintains that an exemption to the disclosure requirements of the Proposed Rule is highly appropriate where an adequate return policy is in place. In fact, such a refund policy does more than the proposed waiting period or any proposed disclosure to protect purchasers of business opportunities from fraud and deception.

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[24] Pre-Paid notes that some commentators have suggested that there be no opt-out option for purchasers of business opportunities. *See* Comment of Department of Justice, at 3. Pre-Paid believes that prohibiting an opt-out only further impinges upon Pre-Paid's relationship with purchasers of its business opportunity.

[25] Proposed Rule, 71 Fed. Reg. 19,054, 19,088.

[26] *See* Pre-Paid Comments, at 7-8.

III. NO COMMENTATOR HAS DEMONSTRATED A NEED FOR BURDENSOME DISCLOSURES WHERE SIMILAR INFORMATION ALREADY IS AVAILABLE, OR WHERE AN ADEQUATE REFUND POLICY IS IN PLACE

Pre-Paid stated in its comments to the Proposed Rule that information similar to that which would be available from the proposed disclosures already is available in the public filings of publicly held companies. Other commenters have agreed,[27] and no commenter has suggested otherwise. Because information about the ongoing health of such businesses already is available, there is no need to force companies to create new disclosures which add little to information which is available from a review of public securities filings.

Consumers also are protected where a company provides an adequate return policy to purchasers of its business opportunity. Such a return policy provides the purchaser with the same protections as those present in typical consumer transactions. Because returning a product is an experience familiar to all Americans, no stigma is created around the fact that a company offers a return policy. In contrast, forcing the suggested disclosures would create an inappropriate stigma around companies like Pre-Paid.

Alternatively, there should be a minimum threshold for the imposition of disclosure requirements upon a business opportunity seller. The Pre-Paid new associate kit is not a business opportunity where there is the potential for thousands of dollars in losses; it costs less than $250. Where there is such a low cost of entry, disclosures are inappropriate and burdensome.

IV. CONCLUSION

Again, Pre-Paid supports the Commission's efforts to eliminate fraud in the sale of business opportunities, but it also has deep concerns about certain features of the Proposed Rule. Specifically, Pre-Paid believes that the disclosures required by the Proposed Rule create a burden on legitimate sellers that is not justified by increased protection for consumers. These disclosure

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[27] Avon Comments, at 11-12.

requirements, combined with the seven day waiting period, will adversely impact legitimate direct sellers like Pre-Paid and the legions of individuals who participate in legitimate direct selling business opportunities.

Pre-Paid therefore urges the Commission to ignore the misleading statements of the few commentators who seek to attack wholly legitimate, value-creating businesses. These commentators misunderstand the purpose of the Proposed Rule, misstate the law regarding illegal pyramid schemes and other fraudulent practices, and misrepresent the facts regarding Pre-Paid and other legitimate sellers. As a result of the commentators' prejudice, their proposals fail to suggest balanced or beneficial changes to the Proposed Rule.

Pre-Paid therefore again requests the Commission to modify the Proposed Rule to exempt from the burdensome disclosures and the seven-day waiting period both (a) publicly held companies and (b) established privately-held companies which have had, for at least two years, a thirty day refund policy. Alternatively, Pre-Paid and its Independent Associates request that the Commission exempt from the Proposed Rule companies whose business opportunity costs $250 or less.

Though this rebuttal has attempted to address Pre-Paid's most significant concerns about comments made to the Proposed Rule, the scope and complexity of the Proposed Rule render it difficult to address all concerns in a single, reasonably concise document. Pre-Paid therefore looks forward to participating in further public discussions of the Proposed Business Opportunity Rule, and, again, respectfully requests the opportunity to participate in any workshops or hearings on the matter.